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No. 777

In the Supreme Court of the United States

October Term, 1949.

LOLA BROOKS, ADMINISTRATRIX OF THE ESTATE OF F. S. BROOKS, DECEASED,
Petitioner,

vs.

ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, A MISSOURI CORPORATION,
Respondent.

Petition for Writ of Certiorari, and Brief in Support Thereof.

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Dated April 25, 1950.

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vs.

ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, A MISSOURI CORPORATION,

Respondent.

PETITION FOR WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS, EIGHTH CIRCUIT.

Lola Brooks, administratrix of the estate of F. S. Brooks, deceased, (hereinafter called petitioner) prays that a writ of certiorari issue to review the judgment (R. 49)[1] of the United States Court of Appeals, Eighth Circuit, entered March 3, 1950, affirming an order of the United States District Court for the Eastern District of Missouri (R. 33), in proceedings for the reorganization under Section 77 of the Bankruptcy Act of St. Louis-San Francisco Railway

1. The record accompanying this Petition pursuant to Rule 38, par. 2, will be referred to herein as (R. .....).

Company, debtor, deciding that the claim of petitioner against the debtor (hereinafter called respondent) is not entitled to priority over its respective mortgages.

Opinions Below.

The opinion of the Court of Appeals (R. 43) is reported at 180 F. (2d) 185. The order denying this petitioner's petition for rehearing (R. 59) is not yet reported. The opinion of the District Court (R. 31) has not been reported.

Jurisdiction.

The judgment of the Court of Appeals was entered March 3, 1950. This petitioner's petition for rehearing was denied March 23, 1950. The jurisdiction of this Court is invoked under Article III, Section 2 of the Constitution and Title 28, United States Code, Section 1254(1).

Statute Involved.

The provisions of Section 77 of the Bankruptcy Act requiring examination are set forth in the Appendix to this petition.

Questions Presented.

ONE.

In equity, is a claim against a railroad company for damages for personal injuries caused to a non-employee by its negligence in operation, while solvent, entitled to payment from its current income in priority over indebtedness secured by pre-existing general mortgages on its estate which provide that current income shall be applied to payment of operating expenses before it is applied to payment of currently maturing indebtedness upon the mortgages?

Two.

In proceedings under Section 77 of the Bankruptcy Act, is the claim described in Question One entitled to priority over the remaining mortgage indebtedness, where the debtor's operating income during solvency, was sufficient to pay the claim, but has been applied to payment of currently maturing indebtedness upon the mortgages, leaving the claim unpaid?

Statement.

Respondent, on July 1, 1916, and on March 1, 1928, respectively, executed the general mortgages upon its estate which here are involved (R. 10, 13). Both mortgages include operating income, provide that until default the mortgagor shall remain in possession of the estate and shall collect and use the income, and that:

> "The railway company covenants and agrees that from such income, after payment of the operating and maintenance expenses of the mortgaged premises embraced in the trust estate"

interest maturing upon the mortgage indebtedness shall be paid (R. 11-12).

January 10, 1930, petitioner's intestate, a non-employee, sustained an injury to his person from the negligent operation by respondent of one of its trains (R. 19-20).

The Interstate Commerce Commission by order establishing regulations effective July 1, 1914, provided that the classification of operating expenses of steam roads shall include expenses on account of injuries to persons occurring directly in connection with transportation service which shall be accounted for as such (R. 10, 13-14). Respondent, in accordance with these regulations, recorded upon its books, and included in its accounting for each year,

as operating expenses, in an account titled "Reserve for Personal Injury and Suits Pending," its estimated liability for damages for such personal injuries accruing during the year, and its estimated liability upon the claim of petitioner was one of the items included in this accounting of operating expenses (R. 10, 16-17 and 22, 28-29).

Claims for personal injury and death were customarily paid by respondent out of its operating revenues (R. 10, 18).

In the years 1930 and 1931 respondent was solvent, its financial position being that reflected by the tabulation:

Year	*Net Available for Interest*	*Dividends Paid*	*Surplus Remaining*
1930	$18,406,000	$ 8,184,068	$17,550,253
1931	10,075,000	6,643,274	9,909,589

During the two years also a total of $32,569,690.48, was expended for maintenance, structures and betterments (R. 1, 2-4).

All interest maturing upon the mortgages prior to January 1, 1933, was paid. No default upon them occurred before that date (R. 1, 2-3). November 1, 1932, at the instance of others than the mortgagees the mortgaged estate was placed in receivership (R. 1, 3).

No action was taken to foreclose the mortgages until March 6, 1933, nor to sequester the income for the benefit of the mortgagees until May 1, 1933.

January 23, 1933, petitioner's intestate obtained in a state court a judgment for $4,000, interest and costs against respondent, with the consent of its receivers, for his damages on account of the personal injury, and filed with the receivers his claim therefor, to which petitioner has succeeded, and the receivers or the successor trustees in bankruptcy paid upon the claim, for costs, $2.30, but no more

(R. 1 and 19, 20-21). The reorganization proceeding under Section 77 of the Bankruptcy Act was commenced May 17, 1933, therein the claim of petitioner was ordered to be treated as refiled with the trustees, and by petition of intervention therein petitioner here asked that the claim be adjudged to have equitable priority over those under the mortgages and to be paid accordingly. Upon motions filed by petitioner and by respondent, respectively, for summary judgment upon the petition of intervention, the District Court, in the order affirmed by the Court of Appeals (R. 33), held as above has been recited.

Reasons for Allowance of the Writ.

1. The questions presented are purely of law, no appreciation of evidence being required for their decision. They are essentially Federal questions. That they must arise in the administration of every proceeding under Section 77 of the Bankruptcy Act is reasonably certain, since claims of the category to which that of petitioner belongs inevitably appear for disposition in the reorganization of insolvent railroads, which, with respect both to subject-matter and number of individual interests involved, has constituted for nearly three-quarters of a century one of the major functions of Federal courts.

It appears that this Court has never been called upon to decide in litigation of railroad reorganization the issue of priority between a claim for damages for personal injury arising from operation and indebtedness secured by a pre-existing mortgage, either where, as here, the mortgage itself provided for postponement of the mortgage debt to expenses of operation, and pre-insolvency diversion of income was alleged, or where some other factual situation was shown. The issue was incidental but was not adjudi-

cated in *Carpenter* v. *Wabash Ry. Co.*, (1940) 309 U. S. 23, which involved the claim of an employee injured in operation before the enactment of the amendment of August 11, 1939, to subsection (n) of Section 77 of the Bankruptcy Act, extending the provisions of that subsection to equity receiverships. The cause was in this Court upon certiorari to the Court of Appeals, Eighth Circuit, which, denying priority to the injured claimant's judgment for damages, had said:

> "But apart from whether judgments of this nature normally have, or may have, priority rights over antecedent mortgage liens, we believe appellant is foreclosed by this record from asserting such rights in this action."
>
> —*Carpenter* v. *Wabash Ry. Co.*, (1939) 103 F. (2d) 996, 1000.

After petition for certiorari was filed, the mentioned amendment to subsection (n) had been enacted, and this Court granted the writ and, conformably with the legislation, reversed the judgment. This Court, noticing the question of non-statutory equitable priority originally present in that case, said at pages 26-27:

> "For the present purpose, we may assume, without deciding, that the determination of the court below was correct upon the record before it * * *. We have held that earnings, while a railroad is in possession of the court and operated by its receivers 'are not necessarily and exclusively the property of the mortgagees' but are subject to the payment of claims which have superior equities as these may be found to exist. (Citing *Fosdick* v. *Schall*, 99 U. S. 235, and *Hale* v. *Frost*, 99 U. S. 389.) Claims having such equities may be accorded priority in payment although they arose prior to the receivership."

This seems to be the sole utterance of this Court upon

the point. The questions here squarely raised should be settled now by this Court.

2. The Court of Appeals based its judgment of affirmance upon the precedent and the doctrine of *St. Louis Trust Co.* v. *Riley,* (8th Cir., 1895) 70 F. (2d) 32, 36, that

> "It is an indispensable element of every such claim that it is founded upon property furnished or services rendered to the mortgagor which either preserved or enhanced the security of the mortgage debt, and thereby inured to the benefit of the mortgagee,"

and held:

> "Since we hold that her claim never was entitled to priority as an operating expense because the negligence resulting to her decedent not only did not inure to the benefit of the then existing mortgagees but was a detriment to them, there could be no diversion by the receivers or the trustees of any fund to which she had a prior right." (R. 43, 49)

The *Riley* case, which the Court of Appeals, upon our application (R. 35, 36), refused to re-examine and to overrule, is the precedent from which have developed all the decisions in the Eighth Circuit not only, but also in other circuits adopting the rule stated in the immediately preceding quotations. Avoidance of unjust enrichment, according to these cases, is the exclusive object of judicial power to award preference to claims for operating expenses.

On the other hand, this Court has defined with utmost clarity the basis of such judicial power:

> "The power rests upon the fact, that in the administration of the affairs of the company the mortgage creditors have got possession of that which in equity belonged to a whole or a part of the general creditors."
>
> —*Fosdick* v. *Schall,* (1879) 99 U. S. 235, 254.

And, referring to *Fosdick* v. *Schall*, decided when the subject of equitable priority between claims for operating expenses and those secured by mortgage was *res integra* here:

> "All we then decided, and all we now decide, is, that if current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of the fund which has been thus improperly applied to their use."
>
> —*Burnham* v. *Bowen*, (1884) 111 U. S. 776, 783.

As pointed out in the Petition for Rehearing below (R. 51), the benefit which is indispensable to the power to award priority to a claim for operating expense, relates, under the decisions of this Court, to the nature of the use by the mortgagor of operating income; but under the decisions in the circuits mentioned, the indispensable benefit relates to the nature of the operating expense upon which the claim is based.[2]

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2. Illustrative is *In re New York, N. H. & H. R. Co.*, (2d Cir., 1937) 92 F. (2d) 428, 430, cert. den. 303 U. S. 650, in which that court said:

> "In *Burnham* v. *Bowen*, 111 U. S. 776, 783, 4 S. Ct. 675, 679, 28 L. ed. 596, Chief Justice WAITE concluded by saying that only those expenses should have priority which were 'for the benefit of mortgage creditors,' language which has been accepted several times since."

The misconception of this Court's language and decision seems obvious. Still, the case from the Second Circuit is cited as persuasive by the District Court which decided this case solely in deference to precedents and against its own expressed inclination and reasoning (R. 31-33), and by the Court of Appeals, which uses language (R. 46) substantially identical with that in the case from the Second Circuit ascribing to this Court the adoption, in the *Burnham* case, of the doctrine, which, in fact, was first announced in the *Riley* case. The conclusion in the *Riley* case was reached after review of 17 decisions of this Court, including *Fosdick* v. *Schall*, in six of which priority was awarded and in the rest was denied to a non-mortgage claim, "not one of them," as is said by Chief Justice BLECKLEY, reaching an opposite conclusion to that in the *Riley* case, in *Green* v. *Coast Line Ry. Co.*, (1895) 97 Ga. 15, 24 S. E. 814, 823, "involving a tort prior to the appointment of a receiver." None of the 17 expresses the doctrine of the *Riley* case.

Thus, for the equity declared by this Court to be the basis upon which priority may be awarded to claims for operating expenses, there has been substituted by the decisions in the *Riley* case and the cases which have followed it, an entirely different equity. This substitution the Court of Appeals has reaffirmed in the case at bar, and its conclusion, consequently, is in conflict with applicable decisions of this Court.

As is suggested by the opinion of the District Court below (R. 31, 32), the conflict between the opposed theories as to which, in reality, is the governing equity, should be settled by this Court.

3. To avoid the possibility of transgressing the rule requiring a petition for writ of certiorari to clearly, completely and definitely expose the controversy, mention is made of the statement in the opinion of the Court of Appeals (R. 48) with reference to Section 77(n) that:

> "Since the statute is jurisdictional in its application to claims for priority in receiverships, the rule is that the affirmative description of jurisdiction implies a negative of the exercise of similar powers not comprehended within the statute."

This statement seems unrelated to the issue actually decided by the Court of Appeals and upon which it affirmed the order of the District Court, by holding that since the claim of petitioner originated, not in benefit, but in detriment, to the mortgagees, it lacked the indispensable quality required to entitle it to priority.

Manifestly, the claim of petitioner is without statutory priority under subsection (n); but if the quoted language implies that her claim, because of the failure of subsection (n) to embrace it, is by that failure interdicted from prior-

ity, whatever the facts respecting it may be, it must be said that the implication is negatived by subsection (b) of the statute itself, which preserves the rights of priority existing at the commencement of the proceeding.

The claims embraced in subsection (n) are required to be preferred against all assets and irrespectively of whether there has been diversion of income or not. "The statute is explicit and mandatory and the District Court has no discretion to act contrary to its terms." *Carpenter* v. *Wabash Ry. Co.*, 309 U. S. 23, 29, *supra.* That subsection (n) is without relevancy, express or implied, to the claim of petitioner is clear.

Conclusion.

We respectfully submit that a writ of certiorari should be granted.

PHIL W. DAVIS, JR.,
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Counsel for Petitioner.

APPENDIX.

Section 77, Bankruptcy Act (Act of March 3, 1933, c. 204, Sec. 1, 47 Stat. 1474; amended Aug. 27, 1935, c. 774, 49 Stat. 911; June 26, 1936, c. 833, 49 Stat. 1969; Aug. 11, 1939, c. 689, 53 Stat. 1406; Title 11, U. S. C. A., Sec. 205):

"(b) * * * For all purposes of this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors.***."

"(n) In proceedings under this section, and in equity receiverships of railroad corporations now or hereafter pending in any court of the United States, claims for personal injuries to employees of a railroad corporation, claims of personal representatives of deceased employees of a railroad corporation, arising under state or Federal laws, and claims now or hereafter payable by sureties upon supersedeas, appeal, attachment, or garnishment bonds, executed by sureties without security, for and in any action brought against such railroad corporation or trustees appointed pursuant to this section, shall be preferred and paid out of the assets of such railroad corporation as operating expenses of such railroad. * * *"

PETITIONER'S SUPPORTING BRIEF.

Specifications of Error.

The Court of Appeals below erred in failing to hold that:

I.

The liability of a railroad for damages for personal injury caused to a non-employee by its negligence in operation is a necessary expense of operation.

II.

Current operating income of a mortgaged railroad accruing before the mortgagees acquire possession or its equivalent are subject to the payment of non-mortgage liabilities for current expense of operation in preference to the debt secured by the mortgages.

III.

The use by a mortgaged railroad, prior to its insolvency, of its current operating income to pay mortgage indebtedness, to the exclusion of a liability for a current expense of operation, is a diversion which results in priority to such liability over the mortgage debt when the railroad becomes the subject of equitable administration.

Argument and Authorities.

I.

In *In the Matter of Chicago, R. I. & P. Ry. Co., Debtor, Wise, et al., Appellants,* (7th Cir., 1937) 90 F. (2d) 312, cert. den. 302 U. S. 717, the court upheld the constitutionality of Bankruptcy Act, Section 77(n), and awarded preference to the claim of a non-employee who had obtained, for damages for personal injuries, a judgment which had become payable by a surety on appeal. Although subsec-

tion (n) was there applicable, the decision as to its constitutionality is based upon the reasoning of the court expressed:

> "The Court, in operating a railroad, must do what the company would have been bound to do if it had remained in possession, pay out of what it receives from earnings all debts, which, in equity and good conscience, considering the character of the business, are chargeable against the earnings." (p. 315)
>
> • • • • • • • •
>
> "The classification of claims as proper to be paid as current expenses from current income is based not upon the bankruptcy act but upon the inherent rules of equity. Congress made no provision for the allowance of priority of current expenses in equity cases, but the Supreme Court found that equity itself demands such classification. • • •
>
> • • • • • • • •
>
> "Let us examine the character of the claims. Though the suits are upon the supersedeas bonds • • • appellant was injured by the negligence of the railroad company in the operation of its trains. • • • Human care and judgment have never been able to eliminate accidents and consequent hurts to persons and property in such a hazardous business as that of operating a railroad. Injuries to the public from negligence are unfortunately far from infrequent • • •. In the very nature of things these risks and events attach to, emanate from and grow out of the process of earning income. They partake of the nature of operating expenses, and therefore, may be classified by Congress as such expenses, payment for which from the income before payment to the mortgagee is only equitable.
>
> "The question of unreasonable and arbitrary classification is one arising upon the specific facts before us, which disclose that the debts to appellants were originally incurred in the earning of the income upon

which the mortgagee claims a lien. Having been incurred in the process of earning income, they partake of the nature of operating expenses and are not unreasonably classified as such * * *." (p. 316)

The doctrine observed in the state courts is that stated by the Court of Appeals, Seventh Circuit:

Smith v. *Eastern R. Co.*, (1876) 124 Mass. 154, 156-157;

Green v. *Coast Line R. Co.*, (1895) 97 Ga. 15, 24 S. E. 814;

McCullough v. *Union Traction Co.*, (1933) 206 Ind. 585, 186 N. E. 300.

II.

An unbroken line of decisions of this Court, beginning with *Gilman* v. *Illinois and Mississippi Telegraph Co.*, (1876) 91 U. S. 603, establishes the priority, as to pre-receivership income, of operating expenses over mortgage debts.

"The substance of these rulings is that until the mortgagee asserts his rights under the mortgage to the possession of the road by filing a bill of foreclosure, or, if the road be in the hands of a third party, by demanding possession of such party, he has no right to its earnings and profits."

—*United States Trust Co.* v. *Wabash Western Ry.*, (1893) 150 U. S. 287, 308.

III.

"* * * In a sense, the officers of the company are trustees of the earnings for the benefit of the different classes of creditors and stockholders; and if they give to one class of creditors that which properly belongs to another, the court may, upon an adjustment of the accounts, so use the income which comes into its own

hands, as, if possible, to restore the parties to their original equitable rights."

—*Fosdick* v. *Schall*, (1879) 99 U. S. 235, 254.

Upon the reasoning of the Court of Appeals, Seventh Circuit, in the *Wise* case, *supra*, it must be true that where no statutory mandate such as subsection (n) requires the payment of a personal injury claim, but diversion of income from its payment has occurred, an equity specifically protected by subsection (b) arises and entitles the personal injury claim to priority payment.

Conclusion.

We respectfully submit that the writ of certiorari should be granted and that upon review the judgment of the Court of Appeals, Eighth Circuit, should be reversed.

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